Case	Condition	Outcome
1	At least one competing bid is within 15% of the lowest bid.	All who bid within 15% of the lowest bid become COLRs.
2	No competing bid is within 15% of the lowest bid but one is within 25%.	The two lowest bidders become COLRs.
3	No bid is within 25% of the lowest bid.	The lowest bidder becomes the exclusive COLR for the area.

The parameters in this auction design – including the use of just three cases and the 15% and 25% cut-offs – are merely illustrative and not based on any detailed analysis. The illustrative rule shows how the auction is constructed to facilitate the presence of at least two actual COLRs in the market when the inefficiency from doing so, in terms of supporting a relatively inefficient competitor, are not too high. A more restrictive standard is set for including competitors beyond the second, because they are expected to contribute less to consumer welfare.

According to theory, the outcome rule described here could be used with any of several different payment rules without affecting the optimality of the auction. The payment rule, however, should be set to respect the other considerations not included in the optimal auctions model. For example, as described earlier, it is desirable to have the same level of support payments for each COLR, for that avoids creating distortions in the subsequent competition among them. One such rule would set each bidder's support payment at the level of the highest accepted bid. Yet another variation would specify that, in case 3 only, the support payment would be set at the level of the second lowest bid.[14]

Each of these variations would change the bidders' strategic problem and lead to different levels of bids being submitted, making cost comparisons among the various rules appear difficult. One of the surprising conclusions of optimal auction theory, however, is that *contrary to simple intuition, the expected size of the support payments to the winners is unaffected by the form of the payment rules (among the set of payment rules that always produce the same set of winners).* A rough explanation for this conclusion is as follows: If one payment rule leads to systematically higher support payments corresponding to any particular bids than another rule, the bidders will offset that difference by submitting systematically higher bids for the rule that calls for the lower support payments.

In practice, the proposed auction would consist of a large number of simultaneous sealed bids for the job of being the COLR. The main difficulty with this proposal is that it fails to allow bidders to account fully for "*cost synergies*," that is, for the possibility that it is cheaper to provide COLR services in one market when they are already providing COLR services in related markets. Such synergies might arise because the related markets used shared switching, transmission or other facilities.

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[14] Another rule would specify that the support payment is the level of the highest accepted bid multiplied by 1.15 in case there are two winners and by 1.3 in case there are three or more winners. Again, the percentages are arbitrary and intended for illustrative purposes only. What is illustrated is that the payments can be made to depend on the number of COLRs selected.

However, permitting combination bids would add significantly to the complexity of the auction design, which is quite important given the possibly large number of small auctions to be conducted. To evaluate the potential benefits of combination bids, one needs to assess the importance of cost synergies.

The need for COLRs arises only in markets where it costs more to serve some potential subscribers than the established maximum basic service rate. If these high cost customers are subscribers who are distant from a town center, then the main cost complementarity may be between serving customers close to town and those at a greater distance from the town center. In that case, if service for the core town will be established anyway, then there are no important cost complementarities in serving two outlying areas bordering the town. If the core town will be served by the COLR in any event, then the model used to study the optimal auction adequately characterizes the basic auction design problem.

However, it may be the case that the bidder, possibly not the LEC, fails to win the COLR designation for the core town and rates for basic service are so low that support payments are required for service to all the potential subscribers in a particular town or other geographic area. In this alternative scenario, a firm's decision to provide any service to the area may depend on its ability to acquire business in the town core, or even throughout the related areas. If the relevant areas are the same for all bidders, one might try to avoid the problem by specifying larger areas for the universal service obligation. However, different customers within any large area may have very different costs of establishing service. That creates a problem as the COLRs avoid offering service to the highest cost customers. This "cherry picking" problem is discussed in more detail in the next section. Even without cherry picking, if the areas with synergies vary among bidders, then the way the areas are carved up is another tricky problem that needs to be resolved in the auction. These cases, which may be called the cases of "*complex cost synergies*," are the most difficult ones for simple auction designs to treat successfully.[15]

My central proposal is based on the presumption that complex cost synergies are of secondary importance, especially in areas where there are to be multiple COLRs, and that it is not worthwhile to adopt the more complex auctions necessary to account fully for cost synergies. In my judgment, the complexity of the combinatorial auction in this context are even greater than was found to be the case in the PCS spectrum auction. Partly, this additional complexity arises from the need to provide uniform pricing in each separate market after the auction, and partly it derives from the very large number of small areas that need to be combined. This complexity suggests that such combinatorial bidding schemes should only be considered where the strength of the synergies means the likelihood of very inefficient outcomes from any non-combinatorial scheme is very high. Even in that case, one might first consider the use of a simultaneous multiple round auction, weighing the risk of collusion against the desire to allow bidders to assess the values of combining service areas.

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15 In the paging, PCS, and SMR auctions, besides any cost synergies, there were important additional synergies from demand side effects. Buyers of PCS services, for example, find the service more valuable when the phone works over a wider

In the next section, to account in a highly imperfect way for cost synergies, I will propose a rule allowing winning COLRs to withdraw bids. The ability to withdraw bids allows the potential COLRs to avoid being forced to provide service in a patchwork quilt of geographic areas. These proposed withdrawals will be subject to penalties, as in the spectrum auctions, to discourage frivolous bidding

III. The Proposed Auction Mechanism

In this section, I outline the major components of an auction for the COLR designation, motivated by the previous discussion of optimal auctions. The kind of auction I propose is in some important respects similar to the kind of auction that GTE has recently proposed to the FCC and other state PUCs.

In summary form, the auction would be conducted as follows. Auctions would be conducted twice annually on specified dates. For each *Census Block Group* (CBG), the FCC or state PUCs would first establish a maximum support rate (the "*reserve*") based on a multiple of the predicted cost under an adopted cost model.[16] A notice process in

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geographic area. In contrast, there appear to be no important demand side synergies in meeting universal service obligations.

16 A multiple greater than 100% of the estimated cost should be used, with the extent of the mark-up dependent on the amount of error in the cost estimates. The mark-up is needed to compensate for "*selection bias*": auctions will be most likely to be conducted for those areas where the model overestimates the costs and will be least likely where the model underestimates the costs. Consequently, a simple 100% rule would leave the LEC receiving the model cost estimate most often when the model most underestimates the actual cost. A reasonable allowance for upward movement also needs to be made when an area is reauctioned to allow for changes that may increase costs over time, such as a change in the definition of the "core" service.

which potential bidders nominate areas in which they are interested in providing service would fix the CBGs for which COLR obligations are to be auctioned. Those making nominations would be required to establish their qualifications to satisfy the COLR obligation. If a party indicates an intention to bid on one particular area for an auction, other parties may nominate additional adjacent areas to auction with that particular area. On the auction date, sealed bids would be submitted indicating the support levels that the bidders require.

In the initial auction for each area, if there are no bids submitted at or below the reserve, the LEC is designated the COLR at an "official" support level determined by the FCC or state PUCs and based upon a cost model (such as the BCM or CPM).[17] This would be treated as if no auction had transpired and the are a would remain eligible to be noticed for auction.

Once a new COLR (instead of or in addition to the LEC) has been established in any CBG, the obligations would be fixed for a period of three years, subject to performance standards. After the initial three year term, any qualified entity could notice the area for an auction. If no one notices these areas, then the incumbents would continue to receive the same level of support payments but without extending the period of protection.

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[17] If the LEC believes that the official rate is too low, it may seek a higher rate from the FCC or state PUC. Of course, the higher rate may encourage other potential COLRs to petition for an auction of some or all of the LEC's COLR service areas.

In order to mitigate the complex cost synergies problem described earlier, I suggest that any bidder be permitted to withdraw its bid from one or more areas. If a bid is withdrawn, the outcome of the auction will be determined as if the withdrawn bidder had never participated in the auction for that area. To discourage frivolous bidding and withdrawals, the FCC and/or state PUCs should establish withdrawal penalties similar to those adopted for the PCS auctions. The penalty might be equal to the larger of any increase in (e.g.) the twelve-month support obligation of the government as a result of the withdrawn bid or, say, $20 per subscriber in the CBG.

In what follows, I describe how these components will serve to ensure that the objective of providing universal service is efficiently attained.

a. The size of the service area.

It is very difficult, if not practically impossible, to define service areas that are homogeneous in terms of the costs of serving subscribers. Heterogeneous costs in a single service area lead to several costly effects. First, the COLRs may have an incentive to avoid serving the higher cost subscribers and to focus their marketing efforts solely on the relatively low-cost subscribers.[18] This problem is compounded when there is competition among COLRs, each of whom may hope to force its

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[18] In general, if an area is sufficiently homogeneous, the COLR will find this kind of discrimination unprofitable because (1) even a subscriber that is more expensive to serve than the average subscriber may make a positive contribution to covering the system's fixed costs and (2) when the heterogeneity is not too great, the cost of discriminating between relatively high- and low-cost subscribers may exceed the profit from successful discrimination.

competitors to serve the subscribers for whom costs are highest. Second, support payments distort competition between COLRs and non-COLRs to serve subscribers for whom service can be provided at relatively low cost. The more heterogeneous the costs of service in an area, the worse these problems are likely to be. Smaller service areas therefore tend to reduce these costs.

An additional advantage of small service areas is that different service providers can assemble groups of areas that fit their technological capabilities. Larger service areas that include geographic areas outside the reach of a potential entrant may dissuade the entrant from bidding.

In economic terms, the choice between small and large service areas is governed by a comparison of the costs of cherry picking plus the costs of the monitoring and regulation needed to mitigate it, the costs of conducting auctions for a multitude of small areas, and the tendency of large service areas to block entry by some service providers. GTE has proposed the use of CBGs (which are quite small service areas) to control the costs of cherry picking and its regulation. If adopted in combination with my proposal for relatively simple, inexpensive sealed bid auctions, the package would constitute a coherent and workable plan for developing market competition.

Question 58 in the Commission's Public Notice asks whether wire centers rather than CBGs should be used as the basis for cost projections. The considerations already discussed above suggest that wire centers have two disadvantages. First, they are relatively large, encouraging cherry picking. Second, they are a natural area only for the incumbent LECs. A new entrant might be able to serve many CBGs but unable to serve the entire wire center, giving the LEC an artificial cost advantage in serving as the COLR. The use of CBGs would be technologically neutral because the definition of a CBG is unrelated to the provision of telephony. Thus, the use of CBGs would tend to avoid the possibility of biasing the auction outcomes towards one technology (or one incumbent).

b. One-shot sealed bids.

The simultaneous multiple-round auction format used in the FCC's spectrum auctions has a number of advantages. Foremost among them is that it permits bidders to take into account the possibilities of substitutability and complementarity among the licenses for which they bid and to adopt back-up strategies (for example, to acquire substitute licenses) in case their primary strategies fail.

In theory, the simultaneous multiple round format should be particularly good at accounting for substitutes, and the FCC experience has borne that out. In the paging auctions, for example, some bidders switched between bidding on the high capacity 50/50 licenses and the lower capacity 50/12.5 licenses during the auction to account for the changing levels of bidding activity. Similarly, in the PCS A and B block auctions, bidders frequently switched between the very similar A and B blocks, substituting between them. The simultaneous design also has important advantages over the sealed bid design in dealing with complementarities when those are important.

Substitution and "back-up strategies" are likely to play much smaller roles in the COLR auction than in the spectrum auctions, because the COLR obligations to service various areas are not technological substitutes. As in the PCS auctions, some substitution possibilities could be generated by a firm's service capacity limitations. Limited budgets could also lead bidders to seek a limited number of COLR obligations. However, the important technological substitution possibilities will be missing.

As against these advantages for the simultaneous multiple round auction, the sealed bid auction has advantages of simplicity and reduced vulnerability to collusion. Any pre-auction collusive agreement among bidders will tend to collapse in the sealed tender auction proposed here because each bidder has a straightforward and powerful incentive to defect from it.

Even if collusion were not an issue, the costs of administering a simultaneous multiple round auction for both the regulator and the bidders may not be worth the benefits. In the PCS auctions, the values of the individual licenses were substantial in comparison to the administrative costs of running the auction and the problem of collusion appears to have been of minor importance. The benefit-cost analysis in this case thus looks quite different than that of the PCS auctions.

c. **Determining the support paid to winning bidders.**

According to the optimal auction analysis in section II, if the bidders respond "rationally" and competitively to one another's strategies, then a variety of rules can be used to determine the support payment without affecting the efficiency of the overall design. Choices among these support rules must therefore be determined by factors apart from those built into the optimal auction model. These factors include (1) the ease or difficulty for bidders of determining their best ("rational") bid, (2) the vulnerability of the rule to collusive behavior, and (3) public perception of the rule as fair and reasonable.

Among the payment rules that might be acceptable according to the optimal auction theory are: (1) the payment is set equal to the lowest rejected bid or to the reserve if all bids are accepted and (2) the payment is set equal to the highest accepted bid. The first of these rules performs poorly in the public perception (as the experience of the New Zealand spectrum auctions demonstrates) and is vulnerable to some collusive bidding patterns.[19] The second rule is readily perceived as fair and reasonable, since it allows the bids to be interpreted straightforwardly as the lowest level at which the bidder offers to supply service. For that reason, I favor it.

d. The number of COLRs.

I would propose that the Commission permit the designation of multiple COLRs for any particular area, the number depending on the differences in the bid amounts. Lacking any quantitative basis for the assignment rule, I tentatively propose the rule described in the previous section. To repeat, that rule is as follows.

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[19] If the reserve is known to the bidders to be very high, there is a Nash equilibrium in which the bidders each bid zero and receive the reserve as their subsidy. This outcome leads to the same kinds of losses that we identified earlier for other forms of collusive behavior.

Case	Condition	Outcome
1	At least one competing bid is within 15% of the lowest bid.	All who bid within 15% of the lowest bid become COLRs.
2	No competing bid is within 15% of the lowest bid but one is within 25%.	The two lowest bidders become COLRs.
3	No bid is within 25% of the lowest bid.	The lowest bidder becomes the exclusive COLR.

There are three advantages of a rule such as this. First, it encourages competition within the market for the patronage of potential subscribers. Second, the presence of multiple COLRs may ease the Commission's burden of monitoring and enforcing the performance of the COLRs after the auction, for several reasons. If some COLR is tempted to avoid serving the highest cost subscribers in a service area, the other COLRs will be led to detect and report that in order to avoid being forced to serve a disproportionate share of those subscribers. Multiple COLRs also provide the regulatory authorities an opportunity to compare the performance of several COLRs in the same market, making it easier to detect false claims about the impossibility of providing some promised services. Moreover, the Commission's threat to impose sanctions, including possible termination of a company's COLR status, is more credible if there are alternative COLRs available to protect consumers against service disruptions.

Third, the approach I have proposed accounts for both the declining benefits from designating multiple COLRs and the cost increases that may accompany a larger number of COLRs. When the bids of the participants are relatively close, the cost disadvantages from multiple COLRs will be correspondingly small, resulting in greater net benefits from multiple COLRs. In this case, the rule would designate multiple COLRs. When the cost differences are larger, the net benefits from multiple COLRs will be smaller, and the proposed rule would limit the number of COLRs designated.

e. The "official" reserve and the auction initiation.

For each CBG, the Commission should establish a maximum support level or "reserve" equal to the difference between the standard rate for the basic service package and a multiple[20] of the cost estimate of providing that package based on an estimation model such as the CPM or BCM. The primary purpose of the reserve is to limit the required support payment in areas where only the LEC can provide economical service. However, the ceiling created by the reserve will also encourage somewhat lower bids in the auction.

After the official reserves have been set, the Commission (or the state PUCs) should allow bidders to nominate CBGs for inclusion in the next auction. This could be done by asking interested parties to submit a Notice of Intent by some specified date before each auction. If the auction for a particular CBG attracts any valid bids from any bidder besides the incumbent LEC, the auction is held; if it attracts no bidders or if only

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[20] As I have already explained, the reserve needs to be based on a multiple of the estimated cost in order to allow the auction to correct errors – both overestimates and underestimates – in the cost estimates and to mitigate the "selection bias" that would be otherwise created.

the incumbent LEC submits a valid bid, the incumbent would retain the COLR obligations at the previously established support level based on a multiple of estimated costs.[21] Similarly, in any area where an auction has not yet been held, the incumbent LEC would retain the COLR obligation at the previously established support level.

For those CBGs for which auctions are held, the designated COLRs would be obliged to provide service beginning, say, one year or eighteen months after the COLR designation. This delay is to permit new entrants whose business plans call for additional facilities investments to make those investments after winning in the auction. This encourages the widest feasible participation in the auction.

f. Exploiting synergies in adjacent CBGs and withdrawal penalties.

Participants in the auction may bid on as many CBGs as they choose, thus permitting bidders some limited flexibility to account for economies of density and scale in their CBG-specific bids. Thus, if a particular entity bids for only one CBG and there are scale and density economies in serving that CBG and adjacent CBGs, then another entity can underbid the first entity in the one-shot auction format.

Some winning bidders may discover after the auction that the aggregation of the particular CBGs won would not permit the bidder to attain all of the expected synergies. This is likely to be a serious problem only if both of the following two conditions apply:

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[21] Any other rule would allow a non-COLR to affect the support price in an area merely by nominating a CBG for auction and without actually bidding, possibly encouraging mischievous nominations.

(1) the bidders' overall cost levels are similar and (2) the synergies are strong. The first condition makes it more likely that each bidder wins a COLR role in several areas, which is a pre-requisite for the problematic "checkerboard pattern," and the second is necessary for the consequences to be economically costly. To help remedy this problem when it is most severe, I propose that a winning bidder be permitted to withdraw its bid for some period after the auction. In effect, a bid withdrawal substitutes partially and quite imperfectly for combinatorial bidding.

When a winning bidder withdraws its bid for a CBG, the auction outcome would be determined by the remaining bids as if the withdrawn winner had never bid. (If only the incumbent LEC remains as a bidder, the auction is canceled, and the incumbent LEC receives support payments at the previously determined level.) This rule prevents any participant from using withdrawals strategically to trigger a new auction, thereby effectively turning a one-shot auction into a multiple-round auction.

Although withdrawals should be permitted, they also need to be penalized. There are two important reasons. First, the withdrawals may disrupt the outcome of the auction and the plans of other bidders and so need to be discouraged. Second, the lack of any penalty may encourage frivolous bidding, in which the bidder attempts to assemble unrealistic combinations or tries to mislead competitors about its future intentions. If there are no penalties, this sort of disruptive bidding behavior is riskless to the bidder.

To assist in maintaining the integrity of the auction, I would propose that the Commission establish moderate withdrawal penalties to deter frivolous bidding, as it did in the PCS auctions. To determine the withdrawal penalty, the Commission would assume that in the future, the winning COLRs would have equal market shares in the CBG. The penalty for a withdrawn bid might be equal to the larger of any increase in the twelve-month support obligation of the government as a result of the withdrawn bid or, say, $20 per subscriber in the CBG. The penalty protects the government from any increases in its support costs and provides some compensation for any loss in post-auction competition resulting from the frivolous bid.

g. The length of the COLR designation.

The length of the time period for which an entity is designated a COLR has several effects. First, a long period ensures that what a bidder wins by making a low bid is of significant value. Second, the period affects the pattern of investments that may be undertaken to provide COLR services.

Encouraging efficient investment is a subtle matter. Optimal investments require that today's COLRs properly anticipate the likelihood that superior technologies will become available tomorrow, replacing the COLR or cutting into its profit margins. Setting too long a period of protection discourages or even blockades entry when the new technology becomes practically available. Setting too short a period may require large initial support payments to allow the investor to recover its investment in a short period. Such support payments may exceed the reserves or be embarrassing to the regulator.

To balance these competing concerns, I have tentatively proposed a three year period for the COLR obligation. To account for cost increases during the interim, the Commission could periodically raise the support rate by an exogenous index of costs, in the same way that the Commission currently implements its price cap policies.

Further, to allow new entry to occur when it is ready, the three year period of protection might not apply to auctions in which the set of COLRs serving an area dees not change, or changes by the exit of a COLR. The three year period of protection would then apply only when a new COLR is introduced into the group serving a particular CBG. The justification is that only a new COLR might be regarded as needing an initial period of predictable competition during which it amortizes its investment.

At the end of the three year period, the areas for which the COLRs were selected via an auction would be eligible to be nominated by qualified parties for a new auction. The rules for these auctions would be nearly identical to those for the original auctions, but taking into account that the COLR for an area may no longer be the LEC. Simply put, the FCC (or state PUCs) would once again announce an official reserve and call for bidders. If no notice of intent is received for a CBG or if there are no valid bids for it, then the incumbent COLRs retain the obligation to provide basic service at the original support rate.

h. Default penalties.

If a bidder defaults, the outcome could be determined as if there had been a withdrawal, as discussed above. However, the costs to the government and consumers will be more substantial the longer the time between the initial auction and the default. This is because the plans of other potential COLRs may have been seriously affected. Consequently, any replacement for the defaulted COLR is likely to demand a higher support level for the shorter-term obligation than for the initial obligation.

Because the COLRs are likely to be parties with continuing relations with the regulators, there are many ways for the Commission to discourage default. The Commission should explore whether it may modify any of its current regulatory penalties for the purpose of deterring the default of a COLR.

i. Transferability of the COLR obligation

As already noted, the proposed auction mechanism has only a limited ability to accommodate synergies in service provision across CBGs. To permit COLRs to realize greater economies after having some experience with the COLR obligation, I would permit a COLR to sell its COLR status to any other qualified company (for example, one that is a COLR in some CBG) that is a non-COLR in that particular CBG. That is, sale would permitted be to a qualified firm (as evidenced by its COLR obligations elsewhere) provided it does not reduce the number of competing COLRs in the affected service area.

Permitting the COLR to sell the obligation after the auction also permits a bidder whose costs are unexpectedly high to transfer the obligation to a more efficient provider.

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

DOCKET FILE COPY ORIGINAL

GTE Service Corporation, et al.,	)	
Petitioners,	)	
v.	)	Case No. 96-3424 (Consolidated with Case No. 96-3321)
Federal Communications Commission and United States of America,	)	
Respondents.	)	

REPLY MEMORANDUM IN SUPPORT OF MOTION FOR STAY PENDING JUDICIAL REVIEW AND FOR EXPEDITED JUDICIAL REVIEW

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INTRODUCTION

Despite their great length, the papers opposing the motions for a stay conspicuously fail to confront the primary arguments overwhelmingly demonstrating that a stay is appropriate in this case. The FCC largely rehashes prior statements about its rules and never directly addresses GTE's arguments based on the text of the Act. And AT&T and others predictably charge that phone companies such as GTE are just monopolists desperately seeking to deprive consumers of the benefits of competition. After all, these parties -- who intend to start offering service over the facilities of existing local phone companies -- stand the most to gain from the FCC's veritable fire sale of the local network. The FCC's rules will subsidize their entry into the market.

There should be no doubt, however, that the posturing in the oppositions is simply that -- posturing. The parties who have the greatest impartial interest in rapidly securing the benefits of competition for consumers are the state commissions. And the Iowa Utilities Board and the Florida Public Service Commission have joined in seeking a stay of the FCC's rules precisely because they recognize the deleterious effects the rules will have in distorting the transition to competition. Thus, as these state commissions recognize, it is a stay of the FCC's unauthorized rules that will hasten the introduction of local competition according to the process outlined by Congress in the Act.

Much of the smokescreen the FCC and its supporters generate rests on three obvious errors.

First, on likelihood of success, the FCC relies on a not-so-subtle sleight of hand. To start, the FCC suggests that GTE's arguments rest primarily on § 2(b) of the Communications Act of 1934, which restricts the FCC's jurisdiction over intrastate matters. The FCC then points to provisions in the 1996 Act that on their face give the FCC some role in implementing local competition. From the obvious fact that the FCC has some legitimate role in implementing certain provisions of the Act, which GTE has never denied, the FCC attempts to draw the insupportable conclusion that Congress intended the FCC to issue national rules governing all aspects of the implementation of local competition, including the setting of prices. That is plainly wrong. Congress expressly reserved for the States the role of determining just and reasonable prices. That reservation of authority, moreover, is consistent with the role the Communications Act has always reserved for the States in setting intrastate rates. Indeed, neither the FCC nor AT&T even attempts to come to terms with the plain language of the Act, which unequivocally provides that "State commission[s] shall . . . establish any rates for interconnection, services or network elements." § 252(c)(2); see also § 252(d). The mere fact that Congress defined a specified role for the FCC in implementing local competition provisions does not mean that, contrary to the express language of the Act, the FCC may usurp the province of the States in setting rates.

Second, to counter GTE's showing of irreparable harm the FCC simply mischaracterizes the effect of its proxies. The FCC represents to this Court that "there is no certainty that [its] proxies will ever be applied to petitioners." FCC Opp. at 37 (internal quotations omitted). That is simply false. In the few short weeks since the rules were published, several States have already determined that they have no practical choice but to apply the proxies. See infra p. 11. And AT&T, while telling this Court that the proxies "in no way foreclose states from implementing different prices," AT&T Opp. at 32, is at the same time urging state commissions that, as a practical matter, they must apply the proxies to meet the deadlines in the Act. See, e.g., Letter submission of AT&T, In re Petition of AT&T Communications of Calif. for Arbitration (Sept. 13, 1996) (suggesting any approach other than the proxies is "obviously impractical"). Such a shell game should not be tolerated. And lest the Court have any doubt that the FCC's proxies are arbitrary and below-cost, the Florida Public Service Commission (PSC), on whose cost studies the FCC relied in setting its proxies, confirms in its motion for a stay that the "FCC's proxy rate . . . bear[s] no relationship to [a LEC's] actual costs" and that the proxies are clearly "arbitrarily low." Florida PSC Mot. at 15.

Third, in asserting that a stay would harm the public interest because it "would prevent the Commission's rules from guiding the terms of competitive entry, as Congress intended," FCC Opp. at 3, the FCC pins its argument on its own erroneous view of the merits. Since, however, petitioners are likely to prevail on their claim that the FCC lacks power to dictate national pricing rules, the public interest will be served by preventing the FCC's unlawful rules from "guiding the terms of competitive entry." A stay of the FCC's pricing rules will thus promote the rapid implementation of the Act in accordance with the procedures established by Congress.

I. GTE IS LIKELY TO SUCCEED ON THE MERITS.

A. The FCC Exceeded Its Jurisdiction By Imposing National Pricing Rules.

1. The text and structure of the Act explicitly reserve authority over pricing to the States.

In well over 100 pages of briefs opposing the motions for a stay, not a single party comes to grips with the central text of the Act demonstrating beyond doubt that the FCC exceeded its jurisdiction by promulgating national rules over pricing. Section 252(d) could hardly be plainer. It is a distinct section of the statute expressly addressing "Pricing Standards." It explicitly directs State commissions -- not the FCC -- to determine "just and reasonable rate[s]" based on standards outlined directly by Congress in the Act, and it nowhere makes any mention of rules on pricing promulgated by the FCC. Where Congress wanted the States to follow FCC rules in arbitrations, however, it clearly knew how to say so. Thus, in outlining States' duties, § 252(c)(1) explicitly requires States to ensure that substantive "conditions" imposed in arbitrations comply with both § 251 and with regulations the FCC is authorized to issue under § 251. In § 252(c)(2), however, Congress addressed distinctly the standards States should apply in "establish[ing] any rates," and -- omitting any reference to FCC rules -- only directed the States to apply the standards set out in § 252(d).

The FCC hardly even attempts to respond to the Act's explicit delegation of authority over pricing to the States. Indeed, instead of addressing the text of the Act reflecting Congress's decision to omit any role for FCC rules in pricing, the FCC would prefer to ignore it.[1] Thus, the FCC baldly asserts that the Court should disregard the fact that Congress directed the States to follow FCC rules in § 252(c)(1) but omitted any reference to FCC rules in the sections addressing pricing, see §§ 252(c)(2), 252(d), because "there was no need for Congress to refer to the Commission's rules in multiple subsections of section 252(d)." AT&T similarly suggests that the Court should ignore the absence of any reference to FCC rules in § 252(d) because, at least in this regard, the language of § 252(d) is "irrelevant." AT&T Opp. at 7. This reading is insupportable. It would render Congress's explicit direction to follow FCC rules in § 252(c)(1) superfluous by importing the same command into § 252(c)(2) and § 252(d), even though Congress excluded any reference to FCC rules in those sections. Cf. In re Bellanca Aircraft Corp. 850 F.2d 1275, 1280 (8th Cir. 1988) (rejecting interpretation that would render part of statute "mere surplusage").

Rather than making any serious effort to confront the terms of § 252(c) and § 252(d) directly, both the FCC and AT&T instead place great reliance on the mere fact that § 251(c), the provision setting out substantive duties imposed on incumbent LECs, also mentions the pricing standards fleshed out in § 252(d). The FCC then claims that, since § 251(d)(1) grants it authority to issue rules under § 251, this power must extend to issuing rules on prices. See FCC Opp. at 18-19; AT&T Opp. at 14-15 That argument is flawed in several respects. In the first place, as GTE has already explained, § 251(d)(1) is not itself a grant of authority. Rather, it simply requires the FCC to act

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[1] At one point, the FCC simply misrepresents the text of § 252(c) by suggesting that the obligation under § 252(c)(1) for States to ensure compliance with the FCC's regulations applies to both the "conditions" imposed in arbitrated agreements and to prices. See FCC Opp. at 14. As explained in the text, that is flatly wrong.

within six months in those areas where it has been given authority. More importantly, § 252(d) makes it clear that States have the role of defining "just and reasonable rates" "for purposes" of implementing the duty imposed in § 251(c). See § 252(d)(1). In other words, § 251(c) and its reference to just and reasonable rates cannot plausibly be read as implying an independent grant of authority to the FCC over pricing terms since § 252(d) expressly states that, for purposes of § 251(c), it is state commissions that will implement the Act by defining just and reasonable rates.

Merely to recite the FCC's contrary interpretation is to expose its absurdities. In essence, the FCC's unstated version of the relationship between § 251 and § 252 would run like this. In § 251(c), Congress imposed duties on incumbent LECs, including for example the duty to offer services for resale "at wholesale rates." Then in § 252(d)(3) -- a section entitled "Wholesale Prices for Telecommunications Services" -- Congress specified that "for purposes of § 251(c)(4)" (emphasis added) a "State commission" was to "determine wholesale rates" based on certain standards outlined explicitly by Congress in the text of the Act. Nevertheless, the FCC's argument goes, what Congress really intended by structuring the statute in this way was to assign the FCC authority to define wholesale rates and to relegate the States to the task of implementing the FCC's dictates. The FCC, moreover, would defend that interpretation even though elsewhere in § 252 Congress explicitly required the States to ensure compliance with FCC regulations, see, e.g., § 252(c)(1), § 252(e)(2)(B), and yet made no mention of any FCC rules on pricing. This interpretation is meritless. While § 251(c) does mention "just and reasonable" rates for interconnection and elements and "wholesale rates" for services, Congress gave content to those pricing standards in § 252(d) and expressly directed state commissions to implement the standards under the definitions in the Act.

Recognizing that the terms of the 1996 Act provide no authority for the FCC's pricing rules, both the FCC and AT&T resort to combing through the Communications Act of 1934 to glean references to general provisions granting the FCC authority to issue regulations. See FCC Opp. at 18 (citing 47 U.S.C. §§ 154(i), 201(b), and 303(r)); AT&T Opp. at 19-20. Indeed, astonishingly, such provisions are the FCC's first line explanation for its power over pricing. See FCC Opp. at 18. It should be plain, however, that such general provisions cannot legitimately be used to twist an explicit grant of authority to the States in § 252(d) into something that it is not -- namely, a grant of paramount authority to the FCC itself. See, e.g., Fourco Glass Co. v. Transmirra Prods. Corp., 353 U.S. 222, 228 (1957) ("specific terms prevail over the general").

2. Section 2(b) Confirms the FCC's Lack of Authority over Pricing.

To divert attention from its failure to address the terms of the 1996 Act, the FCC attempts to suggest that GTE's jurisdictional arguments rely "principally" on § 2(b) of the Communications Act and its explicit limitation on the FCC's jurisdiction over intrastate matters. See FCC Opp. at 20. The FCC then proceeds to distort GTE's position further by arguing that GTE's interpretation of the 1996 Act rests on the broad assertion that Congress restricted the FCC's authority and reserved control over intrastate matters to the States. See FCC Opp. at 24. See also AT&T Opp. at 4. The FCC and its supporters then attack that straw man by relying on a facile syllogism suggesting that if the Act gives the FCC authority over some intrastate matters, it must trump the restrictions of § 2(b) entirely and give the FCC authority over all matters addressed by the Act, including pricing. This argument is flatly wrong.

GTE does not dispute that the FCC was given authority over some intrastate matters in the 1996 Act. See, e.g., § 251(e) (FCC jurisdiction over numbering). But for purposes of the preliminary issues presented on the motions for a stay, the critical question is the FCC's authority over pricing. And contrary to the FCC's erroneous suggestions, the mere fact that the FCC was given authority over some other intrastate matters implies no grant of authority over rates. To overcome